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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 802

ESTATE OF ISAAC G. JOHNSON,
Petitioner,

vs.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

JOHN JAY MCKELVEY,
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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1944

No. 802

ESTATE OF ISAAC G. JOHNSON,

Plaintiff,

against

THE UNITED STATES

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS

To the Honorable Supreme Court of the United States:

The Estate of Isaac G. Johnson, plaintiff above named, prays that a Writ of Certiorari issue to review the judgment of the Court of Claims of the United States entered in the above entitled cause in the office of the Clerk of the Court of Claims on the 2nd day of October, 1944, dismissing the plaintiff's petition.

Opinions

The opinion of the Court of Claims by Littleton, J., will be found at Page 46 of the Record.

The special Findings of Fact will be found at Page 29 of the Record, and the Conclusion of Law at Page 45 of the Record.

Statement

1. The action was begun by the Estate of Isaac G. Johnson as claimant by the filing of its petition in the Court of Claims on December 12, 1942.

2. A General Traverse in answer to the petition of the claimant was filed by the Attorney General on behalf of the United States on January 6, 1943.

3. Thereafter, Hon. Richard H. Akers, commissioner, duly designated by the Court of Claims for the purpose, took the testimony submitted by the respective parties and filed his report with his Findings of Fact on January 7, 1944.

4. Thereafter, the issues came on for trial before the Court of Claims and were argued on May 2, 1944 and submitted on the merits by Mr. John Jay McKelvey for the plaintiff and by Mr. Fred K. Dyar for the defendant, and briefs filed.

5. On October 2, 1944, Special Findings of Fact, Conclusions of Law and Opinion of the Court of Claims of the United States by Littleton, J., were filed and will be found at Pages 29-49 of the Record. Thereafter, judgment was entered dismissing the plaintiff's petition on October 2, 1944.

6. The plaintiff, a New York Corporation, for many years actively operated in the State of New York as a general real estate corporation, buying, selling, exchanging, developing, building, renting and otherwise engaging in the many activities incident to an extensive business over a wide area in the section of New York known as Spuyten Duyvil.

The plaintiff began its operations by purchasing from the executors of one Isaac G. Johnson, who died in 1899, a

part of the real property left by the decedent. Prior to his death, decedent had been engaged in two business activities: (1) the manufacture of steel castings; (2) a general real estate business. Upon his death, he left about twenty acres in area of lands, mostly unimproved, in which he had been dealing, and also the lands and buildings which constituted his steel casting plant.

His sons desired to continue and extend the activities of the father. They organized two corporations—one Isaac G. Johnson & Company which purchased from the estate the manufacturing business, including the plant, the other, a corporation bearing the name "Estate of Isaac G. Johnson" which purchased the miscellaneous real estate. In each case, corporate securities were issued and paid to the estate as consideration for the transfer.

The steel manufacturing business was enlarged and carried on by the sons for upwards of twenty years when it terminated by reason of the condemnation of the entire plant by the State of New York for the widening of the Harlem Ship Canal.

The real estate business was carried on in greatly enlarged form for upwards of twenty-eight years when it was terminated because of the advancing age of the son who operated it.

During the life of the real estate business, the twenty acres originally acquired by the estate were merged into holdings which by purchase from time to time had increased to nearly one hundred acres of improved and unimproved lands. Every form of real estate activity common to an active, going concern was engaged in including the development of special residence parks, the construction of roads, sewers, electric conduits, sidewalks, water and gas mains, single family residences, two family residences, apartment houses, an inn, a club house and a school house for private school.

Subsidiary corporations controlled by the parent corporation, Estate of Isaac G. Johnson, were organized for special purposes, including a construction company, a savings and loan association and two special park development corporations. The business conducted involved the use of capital aggregating several million dollars.

In the conduct of the business, the original twenty acres purchased from the executors of Isaac G. Johnson were merged with the holdings subsequently purchased which were many times in area and value those first acquired. The entire holdings were dealt in alike without distinction as to the source from which acquired.

The certificate of incorporation declared the purposes in language which by no possible construction could be interpreted as a purpose to liquidate property taken over from an estate or any other source.

In 1929, the corporation by resolution declared its intention to cease business and liquidate. From that time it made no further purchases, undertook no further development or construction projects, and engaged in no activities except such as were directed towards sale of its assets and distribution of the proceeds and the maintenance and conservation of such assets pending sale.

Two liquidating dividends were declared as the cash had accumulated to a point where it was considered good judgment to distribute the avails, always having in view the heavy demands for taxes and maintenance pending the complete liquidation.

A series of events unduly prolonged the liquidating period—the financial crash of 1929 followed by the real estate crash of 1932-1933, after which came the long period of real estate depression and then the war.

It is a matter of common knowledge that the real estate market, by reason of these events, during this entire period was so uncertain and, except in special instances of demand

created by defense or other war activities, so dormant that to liquidate holdings, especially unimproved lands, which constituted the bulk of the corporation's holdings, was well nigh impossible.

In spite of the unfavorable conditions, certain public projects initiated by the City of New York resulted in either the sale to the city or the condemnation by the city of a substantial area of the unimproved holdings and by reason of these sales the corporation was able to meet the annual deficits caused by taxes and the upkeep of the properties.

The overhead expense during the years 1937, 1938 and 1939 was reduced to a minimum. Only such clerical work and maintenance and repair work was done as was absolutely necessary to conserve the properties until they could be marketed.

In its capital stock tax return for the prior years 1934, 1935 and 1936, the plaintiff claimed exemption on the ground that it was in liquidation and not doing business within the meaning of the capital stock tax act. After denial of the claim for exemption and the rejection of claims for refund, the plaintiff instituted a suit in the Court of Claims for the recovery of the taxes on the ground that it was not doing business within the meaning of the act. The Court found that "during the period involved the plaintiff has confined its activities to the owning, holding, and preservation of its property with intent to dispose of the same and distribute its avails in liquidation, and did only the acts necessary to continue that status."

The Court held that the plaintiff was not doing business and rendered judgment in its favor. That decision became final without an application for certiorari by the defendant.

The corporation's status remained the same during the following years of 1937, 1938 and 1939. The decision of the

Court of Claims, however, was not recognized by the Commissioner and the Capital Stock Tax was paid and the present suit for refund followed. The same Court upon the same facts reversed itself and after making its Special Findings of Fact, all of which pointed to the inescapable conclusion that the plaintiff was not carrying on business within the meaning of the act, held as a Conclusion of Law: "that plaintiff is not entitled to recover and the petition is therefore dismissed."

It appears from the opinion of Littleton, J. that this result was reached because of a case in the United States Supreme Court *Magruder* v. *Washington*, Baltimore & Annapolis Realty Corp. (316 U. S. 69) which was interpreted as similar in its facts to the present case, although the distinction between the two cases is a glaring one. That the Court's interpretation was erroneous is clearly shown in the Brief which follows:

Statutes

Federal Revenue Act of 1935—Section 105 and Amendments Thereto

(a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1.40 for each $1,000 of the adjusted declared value of its capital stock.

Federal Revenue Act of 1938—Section 601 and Amendments Thereto

(a) For each year ending June 30, beginning with the year ending June 30, (1936) 1938, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

Internal Revenue Code—Section 1200

(a) Domestic Corporations—For each year ending June 30, beginning with the year ending June 30, 1939, there shall be imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

U. S. Treasury Regulation—64

Article 43 (a)—(5) [Code of Federal Regulations Sec. 137.32 (a)—(5)].

(a) *General*—In general, "doing business" includes such activities as:

* * * * * * *

(5) The orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distribution of the proceeds as liquidation is effected—for example the liquidation of an estate, of properties taken over from another corporation, or of shareholders interests in particular property:

* * * * * * *

Article 43 (b)—(2) [Code of Federal Regulations Sec. 137-32 (d)—(1)]

(d) Exceptions—Ordinarily the exceptions to "doing business" are restricted to limited activities of a corporation. For example:

(1) "A corporation [not including a parent company as specified in subdivision (b)] is not subject to the tax if its corporate powers are limited to the mere owning and holding of property and the distribution of its avails, or although incorporated for the purpose of doing business, if it has retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of property, the distribution of its avails, and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs."

Questions Presented

(1) Do the facts as found justify dismissal of the plaintiff's complaint on the ground that the plaintiff was carrying on business within the meaning of the Capital Stock Tax law?

(2) Do the facts as found support the Court's conclusion that the plaintiff was a corporation organized for the purpose of acquiring and liquidating the assets of the estate of a decedent and was during the years in question so engaged, instead of in the orderly liquidation of its own assets?

(3) Do the facts as found support the Court's conclusion that it was a purpose of the plaintiff since 1904, when it was incorporated, to engage in the orderly liquidation of the property acquired by it from the executors of Isaac G. Johnson, deceased, instead of using such property as part of the large volume of assets with which it carried on its extensive real estate and construction business for many years?

(4) Was the Court of Claims correct in holding that its previous decision in favor of the plaintiff in the case of *Estate of Isaac G. Johnson* v. *United States*, 92 Court of Claims 483, has been overruled by the decision of the United States Supreme Court in the case of *Magruder* v. *Washington, Baltimore & Annapolis Realty Corporation*, 316 U. S. 69?

(5) Was the Court of Claims correct in holding that Regulation 64, Article 43(a)(5) (C. F. R. 1938 Sec. 137.32 (a)-(5)) is applicable to the facts as found in the case at bar, or should it have held that said facts bring the case within the exception provided in Regulation 64, Article 43 (b)(3) [C. F. R. 137-32(d)-(1)]

Reason for Granting This Petition

I

That the Court of Claims has drawn contradictory conclusions of law upon facts identically the same in two cases before it between the same parties and it is important that the highest Court shall determine whether the first decision is correct or whether the case of *Magruder* v. *W. B. & A.* Realty Corp., 316 U. S. 69 can serve as a basis for the Court of Claims reversing itself.

II

That it is important for corporate taxpayers to know to what extent the fact that the corporation, in the case of *Magruder* v. *W. B. & A. Realty Corp., supra, was organized for the special purpose of liquidating property acquired from another corporation* influenced the decision of the United States Supreme Court in said case.

III

That the Record, a certified copy of which is presented herewith, shows that the Special Findings of Fact made by the Court were disregarded in the conclusions of law arrived at.

IV

That this case presents for the first time the question of whether the fact that a corporation, organized for the purpose of, and which has for twenty-five years carried on, a general real estate business, purchased from a decedent's estate, a small portion of the property handled by it in its business, has any legal effect on its status as to "doing business" when it decides to liquidate. Does the fact that the property is thus purchased, that it is paid for in cor-

porate securities and that in the final settlement of the decedent's estate such securities are distributed to the beneficiaries under the will, characterize the corporation's business as a liquidating business despite the fact that it is conclusively proved and so found by the Court that the corporation was organized to continue a business carried on by the decedent and for twenty-five years engaged actively in so doing with assets many times in volume and value the property acquired from the decedent's estate.

V

This case presents a question which relates to the application of Treasury Regulation 64 which for the proper administration of the Capital Stock Tax law should be defined so as to leave less opportunity for misunderstanding and misapplication by the Department and the public of its provisions relating to "doing business."

VI

Your petitioner respectfully submits that by the decision of the Court of Claims of the United States it has been denied a refund of taxes erroneously assessed and unjustly collected from it, contrary to the provisions of the law and that it is without remedy unless this Court shall review the decision of the Court of Claims and apply a proper rule of law.

WHEREFORE, your petitioner prays that the petition for a Writ of Certiorari to review the judgment of the Court of Claims of the United States be granted.

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BRIEF IN SUPPORT OF THE FOREGOING PETITION

The facts with respect to the successive steps in the action are sufficiently set forth in the Petition for the Writ, in support of which this Brief is submitted, and need not be repeated in great detail here.

Opinion

The Opinion of the Court of Claims of the United States (R. 46) is reported in Fed. Sup. 57—Page 166.

Jurisdiction

The final judgment of the Court of Claims of the United States was entered October 2, 1944. Jurisdiction of this Court is invoked under Section 240 of the Judicial Code Sec. 3(b) of the Act of February 13, 1925 as amended by the Act of May 22, 1939.

Statement

A brief resume of the facts, none of which are disputed, is as follows:

The plaintiff is a New York Corporation organized in 1904 for the purpose of "acquiring, buying, selling, renting, exchanging, and otherwise dealing in real property, improved and unimproved; the building, construction and alteration of houses and other structures thereon and the management and development of real property generally." In addition, the certificate of incorporation sets forth the usual broad powers incident to the main purposes, as above set forth, but contains no reference in any manner to a purpose to take over from any source property for the purpose of liquidating same. (R. 31, Sp. F. 5).

Upon incorporation, the plaintiff proceeded to engage in the business for which it was organized and as expressed

in the "Purposes" clause of the certificate of incorporation. (R. 32, Sp. F. 5). From its incorporation in 1904 to 1925, the plaintiff engaged in extensive real estate activities of all kinds (R. 32-35, Sp. F. 7, 8, 9, 10).

From 1925, to 1929, the plaintiff had much less activity. (R. 35, Sp. F. 12).

On November 4, 1929, the plaintiff, by former resolution, decided to liquidate its assets and declared a liquidating dividend (R. 35-36, S. F. 13).

After 1929, the plaintiff's activities consisted solely of efforts, through the action of its directors and officers, to dispose of its holdings and distribute the proceeds. (R. 36-39, Sp. F. 14, 15, 16, 17).

The plaintiff corporation was one of two corporations organized by the sons of Isaac G. Johnson subsequent to his death to continue the business activities formerly carried on by their father. (R. 30, Sp. F. 3).

One of the corporations took over from the executors of the Estate of Isaac G. Johnson a large steel casting business, together with the plant and lands used in said business. The steel casting business was carried on for many years until 1923 when the State by condemnation acquired the entire plant and the business ceased. The property taken over from the executors was paid for by securities issued by the corporation and the securities were distributed to the beneficiaries under the will in 1906, upon the final accounting and distribution of the assets of the decedent and the discharge of the executors and trustees. (R. 30, 32, Sp. F. 4, 6).

The other corporation, the plaintiff in this action, took over the real estate with which the decedent had been dealing in his real estate business and paid for it with securities issued for the purpose, which real estate consisted of about twenty acres of property, mostly unimproved (R.

31, Sp. F. 5). With this as a nucleus, the corporation acquired large holdings during the earlier years of its operations and developed, constructed buildings and sold a majority of its holdings prior to 1929. There was no discrimination between the twenty acres originally acquired from the decedent's estate and the approximately eighty acres subsequently purchased. All were dealt in alike as assets of the corporation without separation or distinction in the accounts or on the books of the corporation, the capital stock of which had been increased and new parties admitted as stockholders (R. 31, Sp. F. 6; R. 32-34; Sp. F. 7, 8, 9, 10; R. 35, Sp. F. 11).

When the corporation ceased business in 1929, approximately forty-seven acres in area remained to be disposed of and the proceeds distributed. Of this forty-seven acres, seven or eight acres have since been sold or acquired in condemnation for public use (R. 35, Sp. F. 12).

It was established by undisputed proof and by the exercise of judicial notice on the part of the Court that the market in real estate since the financial crash of 1929 and the real estate depression which followed in 1932 and the following years, was unfavorable towards sales, especially of unimproved property, and the period over which the liquidation has extended has been fully explained and is clearly understood (R. 37, Sp. F. 16). Even the defendant has hardly ventured to urge the time as an element in the case, or to argue that the plaintiff should have sacrificed the property at prices nominal in comparison with values, if indeed any market at all could have been found.

During the years in question—1937, 1938 and 1939—the statement, included in the Special Findings of Fact, give a fairly accurate picture of the financial results of such sales as it was possible for the corporation to make during the entire period. There was no expectation of net profit

and none was realized. Where a single piece, as in the case of some of the land disposed of in condemnation, showed a profit for the particular piece, such profit was more than absorbed during the three year period in the carrying charges consisting largely of taxes and to a meager extent of the expense of maintaining the organization and doing the necessary clerical, repair and maintenance work. The aim was to minimize so far as possible the annual loss until market conditions might so change as to permit the disposal of the main property and the distribution of the proceeds (R. 39-41, Sp. F. 19).

It is obvious that the corporation, not only during the three years in question, but before and since, has been confronted by extraordinary situations which have prevented completion of the "orderly liquidation" which was first entered upon in 1929.

It is also obvious from the facts as found that after the year 1929 and during the years now in question—1937, 1938 and 1939—there was no activity of any sort except that which had for its purpose the expediting of the liquidation upon which the corporation had entered (R. 36-39, Sp. F. 14, 15, 16, 17).

Errors Urged

(1) In refusing to award judgment to the plaintiff for the refund of the amount of taxes assessed against and paid by it as set forth in the complaint.

(2) In holding that the activities of the plaintiff during the years 1937, 1938 and 1939 constituted "doing business" within the meaning of the tax law.

(3) In applying Regulation 64 (a) (5) to the facts of the case and thereby holding that the plaintiff corporation was a corporation organized and operated for the purpose of liquidating assets acquired by it from a decedent's estate.

(4) In refusing to apply to the facts of the case Regulation 64 (b) (2) and to recognize the plaintiff corporation as a general real estate corporation organized for the purposes expressed in its certificate of incorporation, which during the years 1937, 1938 and 1939 had ceased "doing business."

(5) In denying to the plaintiff corporation the right to cease "doing business" within the meaning of the tax law and thus relieve itself of liability for capital stock tax, a right to which every corporation engaged in business is entitled.

(6) In disregarding the Court's own Special Findings of Fact and finding a conclusion of law unsupported by such Special Findings of Fact.

(7) In failing to distinguish between a corporation organized for the purpose of carrying on a general real estate business and a corporation organized for the purpose of doing a business of liquidating the assets of an estate or other corporation.

(8) In finding as a conclusion of law that the plaintiff was not entitled to a refund of the capital stock taxes paid for the years 1937, 1938 and 1939.

ARGUMENT

Summary of Argument

I. A distinction exists between a corporation organized to do a business of liquidating property and a corporation organized for a general real estate business.

II. The business of the plaintiff corporation involved no element of liquidating property taken over from an estate or other corporation.

III. A general real estate corporation has the right, the same as any other corporation, to liquidate its assets as a non-taxable corporation which has ceased doing business.

IV. A corporation dealing in real estate as a business may cease doing business.

V. Certain activities necessarily survive when a corporation doing a general real estate business ceases such business.

VI. Meaning of "carrying out the purpose of its existence."

VII. Treasury Regulation 64 recognizes the distinction between a corporation organized to do a liquidating business and a corporation organized to do a general business which goes into liquidation.

VIII. The decision in *Magruder* v. *W. B. & A. Realty Corporation* (316 U. S. 69) does not overrule, but *confirms* the rule as applied by the Court of Claims in the first *Johnson* case (92 Ct. Cls. 483) and recognizes the distinction above mentioned.

I

The underlying principle of law involved.

The distinction between a corporation organized and operated for the purpose of liquidating assets taken over from an estate or other corporation and a corporation such as the plaintiff corporation which was organized for the purpose of conducting a general real estate business, but which after twenty-five years of activity ceased doing business, is at the base of the entire question raised upon this application.

The Court of Claims failed to recognize this distinction and confused the liquidating of the corporation's assets

with the liquidating of the assets of a decedent which had in fact been completely liquidated many years earlier.

It is true that the organization of the corporation to continue a business conducted by the decedent, followed by purchase of some of the real property of said decedent was helpful towards the final settlement of the estate by the executors, since it put into the hands of the executors securities which were divisible and distributable and thus enabled the estate of the decedent to be completely liquidated and the executors to account and be discharged at an earlier date than would otherwise have been possible, but this did not change the purpose or the character of the corporation, which entered upon its business career and continued its extensive real estate business for over twenty years after the decedent's assets had been finally liquidated.

II

The plaintiff's business never had as a purpose the liquidating of the property of a decedent's estate.

The facts in the case at bar disclose the organization of two corporations to continue two businesses in which the decedent had been engaged. In each case, the corporation was organized to *continue* the business and not to *liquidate* such property of the decedent as might be turned over to the corporation. Each corporation did in fact continue its business for many years and each corporation finally discontinued its business and went into liquidation. There is no distinction between the two so far as the question of "doing business" is concerned. Both were "doing business." Both stopped "doing business." The fact that one was a manufacturing corporation and the other a corporation dealing in real estate and construction did not differentiate the two. The manufacturing corporation was en-

titled "Isaac G. Johnson & Company." The real estate corporation was entitled "Estate of Isaac G. Johnson."

Perhaps, it is this word "Estate" which has brought into the case of the real estate corporation such confusion of ideas on the part of the Court of Claims. This confusion of ideas has persisted all through the consideration of the case by the Commissioner of Internal Revenue. It seems to have been difficult for the Commissioner, and later for the Court, to free the situation from the shadow of a decedent's estate, although the corporation organized to continue the real estate business of the decedent is, of course, a distinct and separate entity organized not to liquidate the assets of an estate, but to take a certain part of the assets and use them in a going business which was expanded and carried on for many years.

The stocks and bonds of each corporation were received by the executors and trustees in payment for the property transferred. Upon the final accounting and discharge of the trustees, such securities were distributed to the beneficiaries under the will. Among the beneficiaries under the will were the sons of the decedent who thus became the stockholders of the corporations, and the estate of the decedent was completely and finally liquidated.

The principal stockholders in the corporation, which continued the manufacturing business in the one case and the real estate business in the other case, were the sons of the decedent, but their character as stockholders was no different from other stockholders in the same corporations. They were not stockholders in corporations doing a liquidating business, but were stockholders in corporations organized for and doing a manufacturing and a general real estate business respectively.

The situation is no different than if the executors and trustees had distributed to the sons cash, left by the decedent or realized from the sale of other assets, (of which

there was an abundance) and the sons had then organized the corporations, subscribed the cash towards the capital stock of the corporations and the corporations had then purchased from the executors and trustees the same property. There is no element in the situation which affects the character of the stockholders or changes the corporations from active business corporations to corporations, the purpose of which was to liquidate the decedent's assets. Had such a purpose been present, there would have been some evidence of action towards carrying out such purpose. The manufacturing corporation proceeded with the business on a large scale, for many years, then ceased "doing business" and liquidated its assets with no question ever raised as to its status, and in the case of the real estate corporation the facts, as found by the Commissioner and as set forth in the Special Findings of Fact by the Court, show only the carrying out of a purpose to enlarge and expand an active real estate and construction business to the greatest limits possible with capital many times greater than that originally subscribed.

Under such circumstances, how can a conclusion such as that set forth, not in the Special Findings of Fact, but in Judge Littleton's opinion, be justified which says: "This orderly liquidation has been a purpose since 1904 when it was incorporated and since 1929 has been the sole purpose of the plaintiff (Finding 27)." Reference to Special Finding 27 (R. 45) discloses no statement to the effect that the orderly liquidation was a purpose when it was incorporated, but does show that during the years 1937, 1938 and 1939 and for about the ten preceding years, the activities engaged in by the plaintiff had for their purpose: "the ultimate disposition of its holdings at a profit without the undertaking of new activities which would interfere with or unduly retard an early advantageous disposition." There is no hint in the Finding that in any activities such as

were formerly carried on from 1904 until 1929, there was any purpose to liquidate property initially acquired from a decedent's estate.

III

A real estate corporation has the same legal status and rights with respect to the Capital Stock Tax Law as any other corporation.

A corporation dealing in real estate is no different with respect to its legal status, whether "doing business" or not "doing business" within the meaning of the tax law, from a merchandising or manufacturing corporation. They are all in a sense dealing with their stock in trade. It happens that in the case of the corporation dealing in real estate the nature of its stock in trade is somewhat different, is less mobile, more difficult to quickly dispose of at a reasonable price and less readily distributable in kind. It consists of lands, buildings and real estate rights of all kinds.

To deal in real estate, the corporation must do something besides sell. In this respect, it is the same as corporations dealing in other kinds of merchandise. It must buy, rent, acquire by exchange, or otherwise replace the merchandise which it disposes of. In this respect, it is the same as corporations dealing in other kinds of merchandise. If it does not replace, create or produce in some form, it is no longer pursuing the purpose for which it was organized and, in the absence of acts showing other object, it is merely liquidating its remaining assets.

IV

A real estate corporation may cease doing business

To cease "doing business" in the case of the real estate corporation necessarily implies that it will cease purchasing

additional stock with which to deal. It cannot mean that it must cease selling or disposing of its stock. In fact, in order to wind up its business, it must get rid of its stock. In the case of ordinary merchandise, this may be done quickly and without sacrificing substantial values. In the case of real estate, however, disposition at a fair value is always difficult, sometimes, depending upon wide-spread financial and market conditions, for long periods impossible and, in any event, calls for a wholly different type of disposition than ordinary merchandise. For this reason, it has not been the tendency of the Courts to hold the corporation dealing in this class of merchandise to the same rules with respect to liquidation as manufacturing and merchandising corporations. A wholesaler may sell out his stock to a retailer by negotiation or auction with little loss. A retailer may advertise and sell his stock to the consumer with a small percentage of loss. A manufacturing corporation may stop its business, relieve itself of all but a trifle of its former expenses and can then dispose of its products on hand without serious loss. If it owns lands, buildings and machinery, complete liquidation may be delayed for a considerable period during which time it will, of course, be in the same position as a corporation dealing in real estate, except that its real estate constitutes but a small fractional part of its assets, the greater bulk of which have been readily disposed of.

V

Activities which survive when a real estate corporation stops "doing business"

As to activities necessary during liquidation, we find the situation differs somewhat in the case of a corporation dealing in real estate from that of other corporations. Its "merchandise," so to speak, must be maintained, kept in

repair, temporarily rented, subject to sale, and its disposition brought about in ways involving lengthy negotiations, and subject to difficulties arising from financial conditions which may prevail in a community, state or nation. Obviously, the result is that the liquidation by a real estate corporation of its assets may be prolonged over a period of many years in spite of the utmost efforts made by the parties interested; yet, during none of the time, can the corporation be said to be "doing business" within the meaning of the tax law.

In the present case, a combination of catastrophies, local at first, state-wide and country-wide next and then world-wide have frozen the market for the sort of real estate held by the plaintiff corporation which, for a period of fifteen years, it has been using its best efforts to get rid of.

The statement covering the years 1937, 1938 and 1939 embodied in Special Finding 19 (R. 39-41) pictures clearly the situation under which the plaintiff corporation was attempting to liquidate its holdings. For the three years period, the statement shows a net loss of $35,220.59. The losses in the years 1937 and 1939 far exceed the profit shown in 1938, which profit resulted from the sale to the City of New York in condemnation of certain lands for public use. The price paid by the City in excess of the 1913 value of the property was considered a profit for tax purposes. It was of vital interest to the stockholders that the property should be disposed of and every effort, as shown by the testimony, was made, but the long depression of 1932, the uncertainties of the several years preceding our entry into the war and the years since entry into the war made such efforts futile and unsuccessful.

Should the stockholders who have steadily lost for the entire period of fifteen years since liquidation was commenced a substantial amount in carrying charges, maintenance and other necessary expenses be further mulcted

on the theory that the corporation has during this period been "doing business" within the meaning of the tax law? The only possible excuse for holding that it has been "doing business" would be if the evidence disclosed that it had been organized *for the purpose of liquidating assets taken over from an estate or another corporation,* but it does not so disclose. If such had been the case the stockholders certainly would not have invested several million dollars in adding to their holdings, organizing subsidiaries, developing large tracts, constructing buildings of all types and otherwise engaging in every form of active real estate dealings. Such activities on their face negative the statement of Judge Littleton that orderly liquidation had been the purpose of the corporation since 1904 when it was incorporated.

VI

Meaning of "Carrying out the Purpose of its Existence"

The ground which is commonly relied upon, in cases which are so near the dividing line between "doing business" and "not doing business" within the meaning of the tax law that they get into the Courts, is usually expressed in the decisions which uphold the Commissioner as "carrying out the purpose of its existence."

Before reaching the conclusion that the corporation is "carrying out the purpose of its existence," the Court necessarily must have found from its incorporation papers what was the purpose of its existence. Inquiry must then have been directed to whether or not the business which the corporation proposed to do was a liquidating business relating to property taken over by it from a decedent's estate or from another corporation to be sold out and the proceeds distributed. If it appear that the activities of the corporation are directed towards such a liquidating process, then it is "doing business" within the meaning of

the tax law for it is, to use the accepted phrase, "carrying out the purpose of its existence."

In our case, no such situation is presented. The "purpose of its existence" is found to have been (R. 31-32, SP. F. 5) the conducting of a general real estate business as set forth in the certificate of incorporation and the corporation is found to have "proceeded to engage in the business for which it was organized and as expressed in the 'purposes clause' of the certificate of incorporation making purchases, sales and otherwise carrying on business as will more fully hereinafter appear" (R. 31-32, Sp. F. 5). Then, in succeeding findings come the detailed description of its activities, which by no stretch of the imagination could be said to involve a single element of a liquidating business.

The meaning of the phrase "carrying out the purpose of its existence" is clear and definite. Its application, in relation to the present case, is equally clear.

It has been directly and unequivocably found by the Court of Claims that the corporation in the present case was engaged in the activities "for which it was organized and as expressed in the purposes clause of its certificate of incorporation." Any statement or conclusion expressed in the Court's opinion as to the corporation carrying out any purpose other than as expressly found can have no weight and cannot serve as a basis for a judgment inconsistent with the findings of fact upon which it must rest. Yet, this is what has happened, and is one of the serious errors which should be corrected on the present application to avoid the unusual spectacle of an opinion and a judgment being wholly inconsistent with the facts as definitely found.

The Court finds in its Special Findings of fact that the purpose of the corporation is A.

The Judge who writes the opinion says that the purpose of the corporation is B and directs judgment accordingly.

The Judgment entered rests on Fact B, which is not found, instead of upon Fact A, which is found.

Manifestly, this is a miscarriage of Justice.

VII

Treasury Regulation 64—Article 43

There has been much misconception of the meaning and application of the Treasury Regulation relating to the capital stock tax. Confusion of thought, as well as words, has contributed to attempts on the part of the Court, strongly supported by the Commissioner of Internal Revenue, to distort the language of the Regulation so as to include as many corporations as possible in the group described in (a)(5) and to give little scope to the exceptions as desicribed in (b)(2).

Common sense analysis and reasonable interpretation of the clauses, which have sometimes been argued to be contradictory, indicate that they are neither contradictory, inconsistent nor in any way incapable of a reasonable business construction. Furthermore, they establish the fact that in formulating said Regulation the Treasury Department clearly recognizes a dividing line between "doing business" and "not doing business" which is dependent upon the determination of the purpose for which the corporation was organized as well as upon its actual activities in the period under review.

Clause (a)(5) defines by way of illustration corporations which will be considered as "doing business" within the meaning of the law as corporations which are engaged in liquidation of assets taken over from the estate of a decedent, or another corporation, or acquired for that particular purpose in some other way. In effect, this means that a corporation organized for the express purpose of liquidating an estate or business is doing the business for which

it was organized and cannot claim exemption from the tax. Liquidating is its business.

Lest this clause (a)(5) should be stretched to cover bona fide cases of liquidation by corporations which have been engaged in some active, manufacturing, merchandising or other form of commercial or financial business and having ceased doing such business are winding up their affairs by liquidation of the assets remaining in their hands and distributing the proceeds, clause (b)(2) entitled "exceptions" was incorporated in the Regulation. This expressly excludes from the classification as "doing business" a corporation which has ceased doing the business for which it was incorporated and has confined its activities to the owning, holding, and preservation of its property with intent to dispose of the same and distribute its avails in liquidation, and has engaged only in such activity * * * in other words, a corporation which, in the language of the Regulation, confines its activities "to the mere owning, and holding of property and the distribution of its avails, or although incorporated for the purpose of doing business, if it has retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of property, the distribution of its avails and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs."

Read together, the clauses are both consistent and capable of application to the facts of each case as such facts may be disclosed by the evidence.

VIII

The decision in the case of Magruder v. W. B. & A. Realty Corporation (316 U. S. 69), confirms the decision in the first Johnson case (92 Ct. Cls. 483).

In the case of *Magruder* v. *Realty Corporation*, (316 U. S. 69) the Supreme Court in its opinion specifically rests its decision upon the fact that the Corporation was created *"for the purpose of liquidating said property belonging to the Railway Company which the company had acquired through foreclosure"* (italics ours) (p. 71). The Court obviously recognized that the corporation was doing the business for which it was created, for it says "During the period in question respondent did not fall into the state of quietude covered by the special language of Article 43(b) (2) in which it was merely owning and holding specific property and distributing the resulting proceeds. On the contrary, respondent was *actively engaged in fulfilling the purposes of its creation*—the liquidation of its holdings for the best obtainable prices." (Italics ours.)

It has been found as a fact by the Court of Claims in the first *Johnson* case and in the case now under review (Court's Special Findings of Fact—92 Ct. Cls. 483) (Fed. Sup. 159) that the Corporation was formed to carry on a general real estate business as set forth in its Certificate of Incorporation, that it actively carried on said business for a quarter of a century and then decided to liquidate the *assets* of the Corporation, not the assets of the deceased individual from whom it had acquired the initial property with which it started business, but the current assets, consisting for the most part of properties, improved and unimproved, acquired during its active business existence.

Clearly, the *Magruder* case is only helpful to the determination of the present case, in that it emphasizes the distinction between a corporation created to do a business of liquidating and a corporation which has retired from the

business for which it was organized and is engaged in liquidating the assets with which it formerly did business.

On what theory, therefore, can it be argued that the Corporation in the present case was "doing business" within the meaning of the Capital Stock Tax Law during the years in question.

The decision in the *Magruder* case (*supra*) cited by the Attorney General precludes such a conclusion, for it emphasizes, as will be noted from the excerpt quoted above, the vital point which determines the issue, namely, the corporation was engaged "*in fulfilling the purposes of its creation.*"

There is no claim that our Corporation has reentered the field of business which it abandoned in 1929, or has engaged in a single activity which had for its object other than of liquidating and distributing its assets. It was not, as was the corporation in the *Magruder* case, "actively engaged in fulfilling the purposes of its creation."

The Attorney General in his suggested Findings of Fact (Suggested Finding V) asked the Court to find:

> "From 1904 until 1929, the plaintiff exercised most of the activities authorized by its certificate of incorporation. It acquired substantial real estate holdings in addition to those previously owned by Isaac G. Johnson, organized subsidiary companies for the development of certain tracts and participated in conjunction with other interests in development projects. It engaged in building, sold and rented properties, borrowed money, etc."

This, the Court found in substance but in greater detail (R. 32-34, Sp. F. 7-10), as the activity prior to 1929.

If this be a correct statement (which it is) how can the Attorney General argue that during the same time it was merely liquidating the property of the decedent *pursuant to the purpose of its creation?*

There can be and has been no dispute as to the actual conditions and the corporate activities prior to the year 1929, when it completely abandoned its former extensive real estate activities; nor can there be any dispute as to the actual conditions and corporate activities since that date. With a single purpose, it has directed all of its efforts towards liquidating its assets so as to finally close up its corporate business. In several respects more rapid progress even than might have been expected, under the stagnation which has existed in the real estate market, was made by the corporation in liquidating its holdings.

It was able to have a considerable portion of its property, about eight acres, taken over by the city for public purposes at reasonably normal prices.

It relieved itself of the expense of carrying properties which were a burden to carry by the demolition of a number of old buildings.

It paid in 1938 a second liquidating dividend.

It took the necessary steps by way of application to the city authorities to have public sewers constructed so as to increase the marketability of the properties.

It offered special inducements to brokers to push the sale of its properties and, while it did not put prices on the property of less than normal value it was ready at all times to consider offers at less than list prices.

At no time, nor in any way did it do anything to prevent the orderly liquidation of its holdings at reasonable prices, which would not unduly sacrifice the values to which its stockholders were entitled.

In the face of the conditions above set forth, how can it be said that the status of the corporation has in any wise changed from its status as found by the Court of Claims for the years 1934-1935 and 1936?

Nothing in the *Magruder* case gives support to the argument that the United States Supreme Court interprets

the law today any differently than it was interpreted by the Court of Claims in its decision in the previous *Johnson* case. The facts have not changed and the principles applicable to them must be the same. If it be not *res judicata* it is at least *stare decisis* and as such should have been controlling.

Another case to which the defendant gives importance is the case of the *Edgar Estates* (65 Ct. Cls. 415). This case also is distinguished from our case in the same way as the *Magruder* case, and the decision was based upon the same ground, to wit: that the corporation was doing the business *for which it was incorporated.* As Judge Booth says (page 422):

> "The corporation came into being to manage, control and dispose of this estate; it had no purpose to continue longer, and while so engaged did carry on and complete all the necessary business activities for which it was distinctly incorporated * * *. *If the corporation was pursuing the object for which it was organized and doing all the essential things to accomplish that object,* it cannot claim a classification of an inactive corporation doing no more than liquidating its assets." (Italics ours.)

Mr. Justice Pitney, in his opinion in the case *McCoach v. Minehill Railway Company* (228 U. S. 295), quotes with approval a statement from *Flint* v. *Stone Tracy Company* (220 U. S. 145):

> "It is therefore apparent, giving all the words, of the statute effect, that the tax is *imposed not upon the franchises of the corporation irrespective of their use in business, nor upon the property of the corporation, but upon the doing of corporate* or insurance *business and with respect to the carrying on thereof* * * * in our opinion the mere receiving of income from the property leased (the property being used in the business by the lessee and not the lessor) and the receiv-

ing of interest and dividends from invested funds, bank balances and the like and the distribution thereof among the stockholders of the Minehill Company *amounts to no more than receiving the ordinary funds that arise from the ownership of property.*" (Italics ours.)

In *Clallam Lumber Co.* v. *United States* (34 Fed. 947) the Court recognizes that a corporation, whose activities are reduced to the mere holding and disposal of its capital assets and the distribution of the proceeds, may properly be considered in liquidation and subject to no capital stock tax.

As there stated:

> "The dominant purpose of activities of the corporation was the final disposal of capital assets, the distribution of their proceeds to the stockholders and the winding up of corporate activities."

Even though the corporation built and operated a logging railroad under contract with a timber purchaser, it was held this was not inconsistent with its liquidating policy but was necessary thereto in order that it might sell its assets.

To the same effect are the *Union Land & Timber* v. *United States* (65 Court of Claims, 129), the *United States* v. *Hotchkiss Redwood Co.* (25 Fed. (2d) 958).

The language of the decision in *McCoach* v. *Minehill Railroad Company* (228 U. S. 295) emphasizes the essential distinction as follows:

> "The distinction is between (a) the receipt of income from outside property or investments by a company that is otherwise engaged in business, in which case the investment income may be added to the business income in order to arrive at the measure of the tax and (b) the receipt of income from property or investments by a company that is not engaged in business except the ownership of the property maintaining the investments, collecting the income and dividing it

among the stockholders. In the former case the tax is payable; in the latter, not."

While the above decision was dealing with an earlier enacted law taxing income (the Corporation Tax Act of 1909), the principle applies in the present case, the pertinent language in the two statutes being the same.

Another of the cases relied upon by the Attorney General *Von Baumrach* v. *Sargent Land Company* (242 U. S. 503), was one in which the corporation's charter was amended so as to declare that:

> "The general purpose of the corporation is to unite in one ownership the undivided fractional interests of the various stockholders in lands, tenements and hereditaments and to own such property and for the convenience of its stockholders to receive and distribute to them the proceeds of the disposition of such property at such times and in such amounts and in such manner as the board of directors may determine."

The Court held quite logically that activities directed to carry out such purpose came within the scope of the "doing of business" under a proper interpretation of the law.

Upon the same principle the following cases were also decided:

Edwards v. *Chile Copper Company* (270 U. S. 452). Mr. Justice Holmes, in delivering the opinion of the Court in this case, says:

> "*It was organized for profit and was doing what it was principally organized to do in order to realize profit.* The cases must be exceptional where such activities of such corporations do not amount to doing business in the sense of the statute." (Italics ours.)
>
> *Chevrolet Motor Company* v. *United States* (67 Court of Claims, 211);
>
> *Conhain Holding Company* v. *Willcuts* (21 Fed. (2) p. 91).

In this case also the activities of the company were definitely confined to the liquidating of assets belonging to the Estate of Louis Conhain, deceased, *which was stated by the Court to be the main object of its incorporation.* This was no case where, as in our case, there was a declared purpose to continue a real estate business, in which business certain land taken over from the deceased person's estate happened to constitute a small part of the capital assets with which the corporation dealt.

Referring to the case of *Von Baumrach* v. *Sargent Land Company* (242 U. S. 503, p. 516), the Court there says:

> "The fair test to be derived from a consideration of all of the cases is between a corporation which has confined its activities to the owning and holding of property and the distribution of its avails and does only the acts necessary to continue that status and one which is still active and is maintaining its organization for the purpose of continuing efforts in the pursuit of profit and gain and such activities as are essential to those processes."

And in the case of *Rose* v. *Nunally Investment Company* (22 Fed. (2nd) 102, at page 104) it is said:

> "There was nothing in the handling of the stocks or bonds which constituted the doing of business. The capital was invested and reinvested and was the activity of the plaintiff which earned the profit. In maintaining its old investments and in making new investments plaintiff was only enjoying the fruits of its ownership and neither those old or new investments were used to further business opportunities or standing out solely for the purpose of producing income."

In *Harmar Coal Company* v. *Heiner* (34 Fed. (2nd) 725) (p. 728), the Court puts the distinction as follows:

> "In other words these decisions indicate not exclusively perhaps, yet quite clearly that when a cor-

> poration is organized for any definite purpose, the ultimate object of which is profit, and it engages in the business of effecting that purpose and then stops the business by reason of sale, lease or other act and thereafter simply hangs on in a corporate sense, receives and distributes the avails of its reorganized affairs, it is not doing business. On the other hand a corporation organized for a definite though limited business purpose involving profit that pursues activities that carry out the purpose no matter how few or small they may be, is carrying on and doing business within the meaning of the statute."

The case of *International Salt Company* v. *Phillips* (9 Fed. (2nd) 389), and the case of *New Haven Securities Company* v. *Bitford* (87 Fed. (2nd) 759), were decided on the same principle that each as a holding company

> "was still actively engaged in the business for which it was incorporated."

It is quite clear that these cases dealing with corporations which are organized to engage in liquidating activities or other activities involving holding securities and properties and distributing returns therefrom are in a different class from corporations which have discontinued the business activities they were organized for and are endeavoring to finally dispose of their assets.

IX

Conclusion

From the foregoing statement of the undisputed facts and discussion of the singular result reached, as evidenced by the opinion of the Court and the judgment entered thereon, the suggestion seems appropriate that the Supreme Court issue the Writ of Certiorari for which application is now made. The corporation should not be treated

differently from any other business corporation which abandons the business purposes for which it was organized and goes into liquidation. The fact that it is a real estate corporation should not exclude it from the privilege of liquidating its assets in the same manner and form as any other corporation, nor from the relief from the capital stock tax which automatically results when a corporation discontinues the business which it formerly carried on and devotes its sole efforts to the disposing of such assets and the distribution of the proceeds to its stockholders. It should not be punished by taxation because it fails to sacrifice at a forced sale, in an unfavorable marketing period, properties from which its stockholders are entitled to realize a normal market value.

The Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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December 20, 1944.

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 802

ESTATE OF ISAAC G. JOHNSON, PETITIONER

v.

THE UNITED STATES

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the court below (R. 46–49) is reported in 57 F. Supp. 159.

JURISDICTION

The judgment of the Court of Claims was entered on October 2, 1944 (R. 49). The petition for a writ of certiorari was filed on December 30, 1944. The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925, as amended by the Act of May 22, 1939.

QUESTION PRESENTED

Whether petitioner was "carrying on or doing business" within the meaning of Section 105 of the Revenue Act of 1935, as amended, and similar provisions of the Revenue Act of 1938 and of the Internal Revenue Code so as to be subject to the capital stock tax imposed thereby.

STATUTES AND REGULATIONS INVOLVED

The applicable portions of the statutes and regulations involved are set forth in the Appendix, *infra*, pp. 13–17.

STATEMENT

The special findings of fact of the Court of Claims (R. 29–45) may be summarized as follows:

Isaac G. Johnson died in 1899 leaving a considerable estate consisting of a large foundry and substantial real estate holdings at or near Spuyten Duyvil, New York City. Shortly after his death, a plan was submitted to his widow and children, who were entitled to the major part of his estate, under which the business interests of the decedent could be continued and a convenient means provided for the distribution of the estate upon its final liquidation to the various parties interested therein. Under that plan two corporations were to be organized, one to carry on the steel business, and the other the real estate business. Accordingly, the petitioner, a New York corporation, was organized in 1904 and acquired from the executors

and trustees of Johnson's estate real estate, consisting of approximately 20 acres; as consideration for the transfer, petitioner's capital stock was issued to the executors and trustees of Johnson's estate. The purposes of the petitioner, as stated in the certificate of incorporation, broadly included almost every phase of dealing in real estate, such as buying, selling, and renting of properties, dealing in stocks and bonds, and supervising, managing, and protecting the property. (R. 29–31.)

The widow of Isaac G. Johnson died in November 1906, and final accounting, settlement, and distribution of the assets of Johnson's estate were made by the surviving executor and trustee. The executor and trustee was finally discharged by decree of the surrogate court on November 30, 1906, and at that time the petitioner's stock which had been received by the executors and trustees, as above set forth, was distributed to the beneficiaries of the estate. (R. 32.)

Petitioner, however, continued its existence and between 1904 and 1925 made further acquisitions of real estate, some of which was improved property, and proceeded in various ways to develop and improve its properties, and engaged in extensive activities in connection therewith, and in the renting and selling thereof. But by about 1925, petitioner had practically ceased purchases of additional properties and by 1929 had reduced its

holdings, totaling approximately 95 acres, to about 47 acres. (R. 32–35.)

On November 4, 1929, the petitioner adopted a resolution stating that it was its policy gradually to liquidate its affairs and resolved that the sum of $150,000, from petitioner's paid in surplus, be distributed pro rata in liquidation among the holders of the stock of the corporation. This was accordingly done. In November 1938, a dividend of $5.25 a share was paid. (R. 35–36.)

During the period from about 1925 to 1929, petitioner discontinued many of its activities previously engaged in and reduced its operation to the maintenance and management of its remaining properties and the making of such sales as it deemed advantageous. It continued in that manner to and including the year 1936 as well as for sometime thereafter, maintaining an office with an accountant, two stenographers, and one or two outside ground keepers, receiving rents, making repairs, seeking legal advice, negotiating with promoters and architects, and considering and undertaking agency contracts and projects for the favorable marketing of its holdings. Substantially the same condition continued through the years 1937, 1938, and 1939. (R. 36.)

The real estate market was adversely affected by the depression which began in 1929 and continued unsettled until the outbreak of the war in Europe, after which there came an almost break-down of

the market for petitioner's property for private use. Petitioner's efforts during that time were directed towards the maintenance of a certain type of development in the area of its holdings which it considered for its best interests in the ultimate disposition thereof. Its president joined the Real Estate Board of the Bronx for the purpose of keeping in touch with real estate movements and to have access to records. He also joined the Home Owners' Association in that area to keep informed and to participate in efforts for or against zoning and other changes. During the years 1937, 1938, and 1939, petitioner did not make any sales to private parties. However, during that period it sold land to the City of New York, reducing its acreage from 45 acres in 1937 to approximately 37 acres. (R. 37–38.)

During the years 1937, 1938, and 1939, and for about the ten preceding years, petitioner engaged in activities which had for their purpose the ultimate disposition of its holdings at a profit without the undertaking of new activities which would interfere with or unduly retard an early advantageous disposition. While the properties were at all times for sale, at no time did petitioner offer them for sale at the best price which could be obtained but it gave consideration to whatever offers were received with the view of determining whether sales at the prices offered would be to its best interest. It continued to carry on with sub-

stantial taxes and operating expenses, with the hope that it might ultimately dispose of its properties on advantageous terms in an orderly liquidation. (R. 45.)

Petitioner filed capital stock tax returns for the fiscal years 1937, 1938, and 1939, claiming exemption on the ground that it was in process of liquidation and was not doing business within the meaning of the capital stock tax act. These claims for exemption were rejected by the Commissioner of Internal Revenue and after assessment the capital stock taxes for those years were paid. Thereafter claims for refund were filed and rejected.[1] (R. 42–45.)

The court below, upon the foregoing findings, held that petitioner was doing business during the fiscal years 1937, 1938, and 1939 and was subject to the capital stock tax (R. 46–49).

ARGUMENT

Capital stock taxes are imposed by Section 105 of the Revenue Act of 1935 as amended and

[1] The Government took the position in the court below that this suit could not be maintained for the recovery of the tax paid for the fiscal year ending June 30, 1937, since it was not brought within two years of March 17, 1939, the date when the Commissioner rejected the refund claim filed on September 7, 1938, and since the second claim, filed June 26, 1941, was not a timely and proper claim. In view of the decision on the merits in favor of the Government the court below did not decide this question. We are reserving this defense but do not believe it necessary to set forth the facts in connection therewith (R. 43–44) in this brief in opposition.

similar sections of the Revenue Act of 1938 and of the Internal Revenue Code (Appendix, *infra*, pp. 13–14) upon every corporation with respect to "carrying on or doing business." Article 43 (a) (5) of Treasury Regulations 64 (Appendix, *infra*, pp. 15–16) provides that, in general, doing business includes any activities of a corporation if it engages in—

> the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distribution of the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from another corporation, or of the shareholders' fractional interests in particular property.

The decision of the court below that the activities of the petitioner corporation constitute doing busines is clearly correct. "Engaged in activities which had for their purpose the ultimate disposition of its holdings at a profit" (R. 45), selling its properties as they could be advantageously disposed of, maintaining an office in connection therewith, receiving rents, making repairs, and performing other acts necessary and incidental to such activities, petitioner certainly falls within the terms of the above regulation which was specifically approved by this Court as a correct interpretation of the law in *Magruder* v. *Washington, B. & A. Realty Corp.*, 316 U. S. 69. In that case the taxpayer corporation was organized

with broad corporate powers by a bondholders' protective committee for the purpose of liquidating certain real properties. From the time of its incorporation it was carrying on negotiations for the sale of properties acquired, selling the same from time to time as satisfactory offers were received, and renting unsold properties in an attempt to earn the carrying charges pending ultimate disposition thereof. This Court held that the corporation came within the terms of the above-quoted section of the regulations which was valid, and that it was, therefore, subject to the capital stock tax.

Petitioner's contention that it is not subject to this tax rests upon the theory that it was a corporation organized to conduct a real estate business which it did for a number of years; that during 1929 it decided to liquidate that business and from then through the years in controversy was engaged in liquidation; and that it, therefore, comes within the provisions of Article 43 (b) (1) of the Regulations (Appendix, *infra*, pp. 16–17).[2]

[2] This Article provides that a corporation is not considered as "doing business" if its corporate powers are limited to the mere owning and holding of property or if it has retired from its regular business and has so reduced its activities. It further provides, however, that a corporation which has retired from its business is subject to the tax "if, nevertheless, it engages in other business activities or maintains its organization for the purpose of continued effort in the pursuit of profit or gain."

In this connection, petitioner asserts (Br. 28–32) that the cases in which corporations engaged in liquidation have been held taxable are those in which the corporation was doing the business for which it was organized. The Court of Claims, however, specifically found (R. 30) that petitioner was organized under a plan whereby a convenient means could be provided "for the distribution of the estate upon its final liquidation to the various parties interested therein." The fact that petitioner's articles of incorporation were very broad and included all phases of the real estate business is not material. Neither is the fact that its extensive activities in its earlier years included purchases of additional real estate. This could well have been a part of its program to liquidate the properties to the best financial advantage of the parties.

Moreover, Article 43 (b) (1) of the Regulations does not recognize any such test as the petitioner suggests, but provides that even if the corporation has retired from its principal business it is subject to the tax if it maintains its organization for the purpose of continued effort in the pursuit of profit or gain.[3]

This Court, in the *Washington, B. & A.* case, *supra,* pp. 72–73, recognized that Article 43 (b)

[3] In the 1936 edition of Regulations 64, referred to in the *Washington, B. & A.* case, *supra,* this provision appeared in Article 43 (b) (2).

(2) (Regulations 64, 1936 edition),[4] is not inconsistent with Article 43 (a)) (5) and was of the opinion that the activities of the corporation in that case fitted into the later Article and that it did not fall into that "state of quietude" covered by the specific language of Article 43 (b) (2). Even if petitioner was organized for purposes other than the liquidation of the estate of Isaac G. Johnson, as it contends, it was actively engaged in business during the years in question. Although its ultimate purpose may have been to liquidate, the properties were to be retained until petitioner obtained good prices. Petitioner was engaged in substantial activities in the pursuit of profit or gain (R. 38, 45). Cf. *Von Baumbach* v. *Sargent Land Co.*, 242 U. S. 503.

The decision of this Court in the *Washington, B. & A.* case, *supra,* has not been limited in its application to those cases where a corporation is organized for the purpose of liquidation but it has been held to cover cases where a corporation, organized for other purposes, has been in liquidation during the taxable years but has carried on activities in connection therewith sufficient to bring it within the scope of the regulations subjecting the corporation to the capital stock tax. *United States* v. *Western Shore Lumber Co.*, 136

[4] This article is similar to Article 43 (b) (1) of the 1938 edition of the Regulations.

F. 2d 628 (C. C. A. 9th); *National Commercial Title & Mortgage Guaranty Co.* v. *Duffy,* 132 F. 2d 86, 90–91 (C. C. A. 3d); cf. *San Fernando M. Land Co.* v. *Commissioner,* 135 F. 2d 547 (C. C. A. 9th).

The fact that in an earlier case involving the same parties the Court of Claims held that petitioner was not subject to the capital stock tax for the fiscal years 1934, 1935, and 1936 (*Johnson's Estate* v. *United States,* 37 F. Supp. 617) does not furnish any ground for certiorari. Petitioner does not contend that such decision is *res judicata,* no doubt because that doctrine is inapplicable under the circumstances. *State Farm Mutual Automobile Insurance Co.* v. *Duel,* decided February 12, 1945, p. 6, slip sheet opinion, No. 115, this Term; *Engineers' Club of Philadelphia* v. *United States,* 95 C. Cls. 42, certiorari denied, 316 U. S. 700, rehearing denied, 317 U. S. 705, and authorities cited; see Paul and Zimet, *Federal Tax Litigation—Selected Problems in Res Judicata* (1937) 32 Ill. L. Rev. 139, 153–154. In its earlier decision, which was prior to the *Washington, B. & A.* decision, the Court of Claims did not consider the effect of the applicable provisions of the regulations (R. 46) and so reached, we believe, an erroneous result. The present decision is in accord with the regulations and with the decision of this Court in the *Washington, B. & A.* case, *supra.*

CONCLUSION

No conflict has been shown. The decision of the court below is correct and the petition should be denied.

Respectfully submitted.

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FEBRUARY 1945.

APPENDIX

Revenue Act of 1935, c. 829, 49 Stat. 1014:

SEC. 105. CAPITAL STOCK TAX.

(a) For each year ending June 30, beginning with the year ending June 30, 1936, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1.40 for each $1,000 of the adjusted declared value of its capital stock.

* * * * *

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 401. CAPITAL STOCK TAX.

(a) Section 105 of the Revenue Act of 1935 is amended by striking out "$1.40" wherever appearing therein and inserting in lieu thereof "$1".

* * * * *

Revenue Act of 1938, c. 289, 52 Stat. 447:

SEC. 601. CAPITAL STOCK TAX.

(a) For each year ending June 30, beginning with the year ending June 30, 1938, there is hereby imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

* * * * *

Internal Revenue Code:

SEC. 1200. TAX.

(a) *Domestic corporations.*—For each year ending June 30, beginning with the

year ending June 30, 1939, there shall be imposed upon every domestic corporation with respect to carrying on or doing business for any part of such year an excise tax of $1 for each $1,000 of the adjusted declared value of its capital stock.

* * * * *

(26 U. S. C. 1200.)

Treasury Regulations 64 (1938 ed.):

ART. 41. *Nature and rate of tax.*—The tax is an excise tax imposed with respect to carrying on or doing business during a taxable year ending June 30, or any fractional part thereof. It is an excise tax upon the exercise of the privilege of doing business and not upon the business itself and is imposed upon each corporation with respect to carrying on or doing business and not upon each business carried on. If more than one corporation is engaged in carrying on a single business, each must file a return and pay the tax. The tax is imposed at the rate of $1 for each full $1,000 of the adjusted declared value of the capital stock. The tax may not be apportioned under any circumstances. If a corporation is engaged in business for any portion of a taxable year, liability for the tax is incurred for the entire taxable year.

ART. 42. *Doing business.*—The term "business" is very comprehensive and embraces whatever occupies the time, attention, or labor of men for profit. Accordingly, regardless of the nature of its activities, any corporation organized for profit and carrying out the purpose of its organization is doing business within the meaning of the Act. Similarly, even if not organized for profit, any corporation which

engages in activities ordinarily carried on for profit is doing business. It is immaterial whether the activities result in a profit or a loss, or whether the corporation has been successful in its enterprise, or that because of unfavorable business conditions, no operations are carried on for a particular period. No particular amount of business need be done, nor is it necessary that the business be continuous throughout the taxable year.

The case is exceptional in which the activities of a corporation organized for profit do not amount to doing business within the meaning of the Act. Such a case is generally limited to one in which the corporation is not pursuing the ends for which organized, i. e., profit.

ART. 43. *Illustrations.*—(a) *General.*—In general "doing business" includes any activities of a corporation whether it engages in—

(1) buying, selling, manufacturing, developing, financing, speculating, or otherwise dealing in or managing, property of any description;

(2) furnishing services of any character;

(3) leasing or managing properties, collecting rents or royalties;

(4) managing, financing, controlling, or directing the operations, performing any function, or in any other way aiding or serving the general purposes of any affiliated or related company;

(5) the orderly liquidation of property by negotiating sales from time to time as opportunity and judgment dictate and distribution of the proceeds as liquidation is effected—for example, the liquidation of an estate, or of properties taken over from

another corporation, or of the shareholders' fractional interests in particular property;

(6) investment or reinvestment (in the case of a corporation holding securities) of surplus or other funds in additional securities, with the exception of the reinvestment of funds realized upon the maturity or redemption of securities;

(7) leasing all its properties to another without divesting itself of all control and management of the properties under such terms that it keeps the properties in repair, or engages in other activities necessary to enable the lessee to utilize the leased properties, regardless of whether such activities are performed on behalf and under the order of the lessee or whether such acts are of major importance; or

(8) any other activities coming within the ordinary and natural signification of the term "carrying on or doing business."

(b) *Exceptions.*—Ordinarily the exceptions to "doing business" are restricted to limited activities of a corporation. For example—

(1) A corporation is not subject to the tax if its corporate powers are limited to the mere owning and holding of property and the distribution of its avails, or, although incorporated for the purpose of doing business, if it has retired from the business for which it was organized and has reduced its activities to the mere ownership and holding of property, the distribution of its avails, and doing only such acts as are necessary to the maintenance of its corporate existence and the private management of its purely internal affairs. However, a corporation which has retired from its principal business is subject to the tax if, nevertheless, it engages in other business activities or maintains its organization

for the purpose of continued effort in the pursuit of profit or gain.

(2) A corporation may complete its organization and sell its capital stock for cash without incurring liability. However, the exchange of its capital stock for property other than cash or the use of the proceeds from the sale of its capital stock for the purchase of property are corporate business acts and constitute doing business. Entering into contracts for the purchase of property or the construction of a plant are also corporate acts and constitute doing business. In other words, it is not necessary that a corporation be actually engaged in the manufacture of its intended product or that it be actually creating profit or gain to incur liability, since making contracts, buying materials or machinery, and employing and discharging individuals are necessary business acts leading to the ultimate attainment of the objects and purposes for which the corporation was created and has its existence.

(3) A corporation will not be regarded as "doing business" if it had no activities during the entire taxable year, because it has—

(a) become dormant; or

(b) completed its business, as, for example, where a real estate subdivision has been developed, sold and reduced to cash; or

(c) abandoned its business, as, for example, where prospective oil properties are proven worthless.

Articles 41, 42, and 43 of Treasury Regulations 64 (1936 ed.), though arranged somewhat differently, are substantially the same.

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